SCOPE OF ECONOMIC INQUIRY IN DETERMINING SUBSTANTIALITY OF EFFECT ON COMPETITION UNDER CLAYTON ACT

Timken Roller Bearing Company v. Federal Trade Commission
299 F.2d 839 (6th Cir. 1962)

The United States Court of Appeals set aside a cease and desist order issued by the Federal Trade Commission against the Timken Roller Bearing Company and dismissed the complaint which charged the Timken Company with violation of section 3 of the Clayton Act[1] by following a consistent policy of exclusive dealing[2] in tapered roller bearings.[3]

The Clayton Act[4] is primarily concerned with preserving business competition as a regulator of our economy by allowing price to be set by the demand for a product and its production cost. This scheme of regulation is intended to produce the best allocation of economic resources, a high quality of goods, a reduction of production costs and an equitable division of income between consumer and producer.[5] An essential objective of the

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[1] 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958):

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

For other antitrust law applicable to exclusive dealing contracts and the restraint of trade, see section 1 of the Sherman Act, 69 Stat. 282 (1890), 15 U.S.C. § 1 (1958), and section 5 of the Federal Trade Commission Act, 74 Stat. 200 (1914), 15 U.S.C. §§ 41-45 (1958).

[2] Exclusive dealing may be defined as selling or leasing on condition that the buyer or lessee shall not use or deal in the goods of a competitor. Pick Mfg. Co. v. General Motors Corp., 80 F.2d 641 (6th Cir. 1935).

[3] Timken Roller Bearing Company v. Federal Trade Commission, 299 F.2d 839 (6th Cir. 1962).

[4] 38 Stat. 730 (1914), 15 U.S.C. §§ 12-27 (1958).

[5] See Report of the Attorney General's National Committee to Study the Antitrust Laws 317 (1955). This was not the purpose of the early common law against restraint of trade. See Jordan, "Exclusive and Restricted Sales Areas Under the Anti-Trust Laws," 9 U.C.L.A.L. Rev. 111, 132 (1962), citing *Dyer's Case*, Y.B., 2 Hen. V, vol. 5, pl. 26 (1415), to the effect that the chief concern of the common law had been that the victims of contracts in restraint of trade would not become public charges.

Clayton Act was to strengthen the Sherman Act of 1890,[6] which, through judicial interpretation, had allowed certain monopolistic practices to persist. The courts had read the Sherman Act's prohibition against restraint of trade to mean *unreasonable* restraints and held that a restraint was not unreasonable if it were imposed for a recognized business purpose and without obviously bad economic consequences.[7] Specifically, section 3 of the Clayton Act aims at cutting off in its incipiency any lease, sale, contract or agreement made on the condition that the purchaser shall not use or deal in goods of a competitor of the seller,[8] where the effect of such arrangement may be to substantially lessen competition or tend to create a monopoly in any line of commerce.[9] The relevant tests of legality to be used under the Clayton Act are neither the "rule of reason" test of the Sherman Act nor that of per se illegality,[10] but are determined by the interpretation given the last clause of section 3,[11] which has variously been called "the qualifying clause" and the "competitive impact clause."[12]

In the formative period of the Clayton Act, the courts applied a full inquiry rule of reasonableness test to determine what factors substantially

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[6] 69 Stat. 282 (1890), 15 U.S.C. §§ 1-7 (1958).

[7] Schwartz, "Potential Impairment of Competition—The Impact of Standard Oil v. United States on the Standard of Legality Under the Clayton Act," 98 U. Pa. L. Rev. 10 (1949).

[8] Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 356 (1922).

[9] Barber-Colman Co. v. National Tool Co., 136 F.2d 339 (6th Cir. 1943); R.C.A. v. Lord, 28 F.2d 257 (3d Cir. 1928). In addition to exclusive dealing contracts, another type of business arrangement that often runs afoul of section 3 is the so-called "tying contract." In a tying contract, Seller agrees to sell the desired product *A* but only on the condition that Buyer also purchases product *B* or at least will not purchase *B* from a competitor of Seller. See Osborne v. Sinclair Refining Co., 286 F.2d 832 (4th Cir. 1960). Tying contracts are seldom explainable on any other ground except restraint of competition and for that reason are usually judged on more of a per se standard of illegality than are exclusive dealing contracts. Dictograph Products v. Federal Trade Commission, 217 F.2d 821 (2d Cir. 1954), *cert. denied,* 349 U.S. 940 (1955). *But cf.* United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam,* 365 U.S. 367 (1961), and Note, "Exclusive Dealing Arrangements Under the Antitrust Laws," 47 Va. L. Rev. 675, 685 (1961).

[10] McAllister, "Where the Effect May Be to Substantially Lessen Competition or Tend to Create a Monopoly," in An Antitrust Handbook, Section of Antitrust Law, American Bar Association (1958).

[11] "Where the effect . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce." 38 Stat. 730 (1914), 15 U.S.C. § 14 (1958).

[12] See Lockhart and Sachs, "The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act," 65 Harv. L. Rev. 913, 934 (1952), for a concise legislative history of the evolution of section 3 and its qualifying clause, and also McAllister, *op. cit. supra* note 10, at 218. Section 3 was essentially a compromise between factions wishing outright prohibition of arrangements tainted in any way with exclusivity, those desiring criminal sanctions therefor, and those believing that the matter was best left to the discretion of the Federal Trade Commission under section 5 of the newly enacted Federal Trade Commission Act.

lessened competition.[13] However, a trend toward foreclosure of the scope of inquiry reached its culmination in *Standard Oil of California v. United States*.[14] The issue in *Standard* was whether or not the qualifying clause required, in addition to proof of substantial, potential effect on the line of commerce, proof of actual comparative effect of lessening commerce in the line of commerce in question. In a 5-to-4 decision, the Court held that the qualifying clause of section 3 did not necessitate a searching inquiry into the actual effect on competition and declared that the requirement of substantiality was satisfied by proof that a substantial share of the market was affected. Standard was the largest seller of gas in a seven-state western area. Under its exclusive supply contracts, Standard's independent service stations handled $57,646,233 worth of gasoline. This amounted to 6.7% of the total market and the Court held that this was a substantial share.[15] The Court refused to admit evidence submitted by Standard of its relatively slipping position in the industry in comparison with its competitors, saying that deeper economic inquiry would be out of place.[16] The criterion thus evolved from *Standard* takes into consideration the exclusive nature of the contract, the dollar and percentage volume of trade affected, and the leading position of the seller in the industry. The test has been labeled one of "quantitative substantiality" because of its stress on dollar amounts. The test, however, has been criticized as being unrealistic because relevant economic factors which could show that the suspect arrangement's benefits far outweigh its adverse effects on competition are ignored.[17]

The critics of the quantitative substantiality test have hailed the case of *Tampa Electric Co. v. Nashville Coal Co.*[18] as a welcome step in the direction of economic sophistication under the Clayton Act.[19] In *Tampa*

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13 Comment, "Federal Anti-Trust Laws—Exclusive Dealing—Standard of Illegality Under Section 3 of the Clayton Act," 59 Mich. L. Rev. 1238 (1961); Schwartz, *supra* note 7. See Pick Mfg. Co. v. General Motors, *supra* note 2, which held that a requirement by an auto manufacturer that its dealers agree not to use parts manufactured by its competitors in repair of its motors did not violate section 3 of the Clayton Act because it did not substantially impair competition and was justified in protection of the manufacturer's goodwill.

14 337 U.S. 293 (1949).

15 *Id.* at 295. The court also held that 2% of the tire and battery market affected by these contracts was substantial.

16 See Comment, *supra* note 13, at 1242, for the opinion that the Court in *Standard Oil* did not mean to rule out extensive market analysis in all section 3 cases but merely deemed it futile in this particular case.

17 See Lockhart and Sachs, *supra* note 12, at 923. The authors identify some economic factors that would be relevant, *e.g.*, the proportion of dealer outlets controlled by the arrangement, the extent to which other sellers also use this device, the difficulty for a newcomer to break into competition, the duration of the arrangement, and the new devices that would arise if this one were struck down. This last point embodies a fear expressed by Mr. Justice Douglas in his dissent in *Standard Oil*, *supra* note 14, at 319.

18 365 U.S. 320 (1961).

19 See Handler, "Recent Antitrust Developments," 71 Yale L.J. 75 (1961).

Electric, the United States Supreme Court held that a requirements contract under which a Kentucky coal company supplied all the coal for a Florida utility for a period of twenty years did not on the facts violate section 3 of the Clayton Act.[20] The Court, speaking through Mr. Justice Clark, said there was insufficient evidence to warrant a conclusion that competition would be substantially affected in the relevant market.[21] The Court stated that in order to determine the substantiality of the share of the relevant market foreclosed by an exclusive dealing contract:

> . . . [I]t is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relevant strength of the parties, proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and probable immediate and future effect which pre-emption of that share of the market might have on effective competition therein.[22]

The test enunciated in *Tampa Electric* was confined to the question of determining the relevant market in which competition would be affected. Nevertheless, *Tampa Electric* seems to dictate that henceforth the entire question of substantiality should be answered only after a thorough economic inquiry by the court.[23]

The attitude of the Federal Trade Commission[24] throughout this course of judicial interpretation of section 3 should be considered. While the courts were foreclosing economic inquiry under the *Standard Oil* test, the Federal Trade Commission under its *Maico* doctrine[25] felt that it possessed expertise which the courts lacked and therefore considered evidence such as the increased number of competitors and a decline in defendant's share

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20 The cost of the coal rose in time to over a million dollars annually which is more than is paid for coal in the whole Florida Peninsula.

21 The Court found that the relevant market was not the Florida Peninsula, nor even the whole state of Florida, but rather the Appalachian coal district where the utility company could have turned to any of the seller's competitors. Seen in this context, the exclusive dealing arrangement tied up less than 1% of the market. The Court also found some justification for a requirements contract where a utility was involved in that it was in the public interest that the utility have an assured supply of energy. Tampa Electric Co. v. Nashville Coal Co., *supra* note 18, at 331.

22 Tampa Electric Co. v. Nashville Coal Co., *supra* note 18, at 329. Compare this broad economic inquiry with the *Standard Oil* test of quantitative substantiality which is based largely on dollar amounts.

23 "Although the narrow holding of *Tampa Electric* turned on the proper definition of the geographic market, what Mr. Justice Clark, writing for a seven member majority, did to *Standard Oil* is as neat a piece of judicial surgery as has been seen in some time." Handler, *supra* note 19, at 82. See Curly's Dairy, Inc. and Timber Valley Dairy, Inc. v. Dairy Cooperative Association, 202 F. Supp. 481 (D.C. Ore. 1962).

24 The Federal Trade Commission has jurisdiction of section 3 cases by virtue of section 11 of the Clayton Act, 15 U.S.C. § 21 (1958). For private treble damage suits based on restraints of trade, see 15 U.S.C. § 15 (1958).

25 The Maico Co., 50 F.T.C. 485 (1953).

of the market as defenses in section 3 actions.[26] However, the Federal Trade Commission subsequently overruled *Maico* by rejecting economic data offered by the defendant in justification of an exclusive dealing arrangement, and thus followed the foreclosure test of *Standard Oil*.[27]

This important question of the scope of economic inquiry in determining substantiality of effect on competition was not answered in *Timken*.[28] The Court reversed the Federal Trade Commission on a far more basic point, *i.e.*, that the Federal Trade Commission failed to show a policy of dealing on condition, agreement, or understanding of exclusivity. The Court concluded that Timken had perhaps dismissed one dealer who handled the products of a Timken competitor, but pointed out there is a difference between the forbidden exclusive dealing contract and the right of a seller to choose freely with whom he will deal or continue to deal.[29]

The vagueness of the tests of legality under section 3 and the seeming lack of rapport between the courts and the Federal Trade Commission make it difficult to predict when the sanctions of the Clayton Act will be applied. It does appear, however, that the pendulum is swinging away from the standard of per se illegality and toward a reasoned practice of evaluating economic realities that should be considered. It is a fair guess that in the future many business arrangements which in actuality do not harm competition will no longer be struck down on a mere showing of large dollar amounts in the suspect contract.

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[26] Comment, "Section 3 of the Clayton Act—A Law Unto Itself," 22 U. Chi. L. Rev. 233 (1954).

[27] Mytinger & Casselberry v. Federal Trade Commission, 25 Fed. Reg. 11208 (1960), *aff'd*, 301 F.2d 534 (D.C. Cir. 1962).

[28] The Federal Trade Commission explicitly followed the exclusionary rule it recently adopted in *Mytinger & Casselberry*, *supra* note 27.

[29] Timken Roller Bearing Company v. Federal Trade Commission, *supra* note 3, at 842. See McElhenney Co. v. Western Auto Supply Co., 269 F.2d 332 (4th Cir. 1959); Hudson Sales Corp. v. Waldrip, 211 F.2d 268 (5th Cir. 1954).